In the

United States Court of Appeals

FOR THE NINTH CIRCUIT

No. 22598

REPUBLIC NATIONAL LIFE INSURANCE COMPANY,
Appellant,

v.

HAMILTON LIFE INSURANCE COMPANY OF NEW YORK and FINANCIAL SECURITY LIFE INSURANCE COMPANY,
Appellees.

BRIEF OF APPELLANT

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JURISDICTION

The District Court had jurisdiction of this case under 28 U.S.C., Section 1332 as the action was commenced by Appellant, a Texas corporation against Appellee, Hamilton Life Insurance Company of New York, a New York corporation, and Financial Security Life Insurance Company, an Arizona corporation, and involves more than $10,000. Venue rests in the United States District Court for the District of Arizona, being the District where Financial Se-

curity is incorporated and where Appellant and Appellee are licensed to do business. The action is one for the declaration of the rights and legal relations between the parties arising out of an agreement for reinsurance and coinsurance of insurance business and for the rescission of such agreement, and for such other relief as may be granted. 28 U.S.C., Sections 2201 and 2202.

The United States Court of Appeals for the Ninth Circuit has jurisdiction of this appeal of an order staying a civil action pursuant to the United States Arbitration Act. *Ross v. 20th Century-Fox Film Corp.*, 236 F. 2d 632 (9th Cir. 1956) and *Ets-Hokin and Galvan Inc. v. United States ex rel. Pratt*, 350 F. 2d 871 (C.A. 9, 1965). 28 U.S.C., Sections 1291 and 1292.

STATEMENT OF FACTS

The action now pending appeal was commenced in the United States District Court for the District of Arizona on November 3, 1967, by the Plaintiff, a Texas insurance corporation, against two other insurers, Hamilton Life Insurance Company of New York, a New York insurance corporation (referred to below as "Hamilton") and Financial Security Life Insurance Company, an Arizona insurance corporation (referred to below as "Financial Security") for rescission, damages and a declaratory judgment of the rights and liabilities of the three parties. (Record 1-7) The relationship of the parties arises from a parol reinsurance and coinsurance contract by which certain insurance business originated by the Defendant, Hamilton, was to be ceded for

reinsurance to the Plaintiff, Republic National, upon condition that 80 percent of such insurance be retroceded for further reinsurance by Financial Security. (Record 2-3, 63, 69) Pursuant to this parol contract, the cessions were made as evidenced by two written reinsurance agreements, one between Hamilton and Republic National, and the other between Republic National and Financial Security, both attached to the Complaint. (Record 1-9 and exhibits)

On December 15, 1967, subsequent to the institution of this action, the Plaintiff was served with notice that Hamilton, a defendant in this action, had commenced action under 9 U.S.C. Section 4 on December 11, 1967, in the United States District Court for the Southern District of New York, to compel arbitration of disputes existing between Hamilton and Republic National under the written portion of the reinsurance and coinsurance contract described in Republic National's Complaint. (Record 27) On December 15, 1967, Hamilton filed its Motion for Stay or Proceedings Pending Arbitration pursuant to 9 U.S.C. Section 3, in the United States District Court in Arizona. (Record 10) To prevent the conflicting exercise of jurisdiction, the Arizona District Court temporarily restrained the Defendant, Hamilton, from proceeding in New York (Record 37) and after a hearing, issued an interlocutory injunction to the same effect. (Record 72) Hamilton moved to quash the interlocutory injunction. (Record 75)

Defendant, Financial Security, filed a motion to dismiss for failure to include an indispensable party which was not ruled on by the District Court; Hamilton's motions to sever and dismiss were denied. (These instruments not made part of the record) Appellant filed its Motion for Partial Summary Judgment (Record 63) which was not ruled upon by the Court.

Finally, by its orders of January 29, 1968, (Record 83) and February 15, 1968, (Record 101) the District Court in Arizona granted Hamilton's motion to stay the proceedings in Arizona pending arbitration pursuant to Section 3 of the Federal Arbitration Act, 9 U.S.C. Sections 1-14, while refusing the rule upon Republic National's contention that 15 U.S.C. Sections 1011-1015, commonly called the McCarran Act, exempts the insurance business from the coverage of the Arbitration Act. The injunction against proceedings in New York was then dissolved. (Record 84) The District Court, recognizing the gravity of the legal issues then stayed its own orders until February 26, 1968, (Record 102) to enable Appellant to obtain a continuation of the stay order from the United States Court of Appeals. The District Court orders were temporarily stayed until March 4, 1968, by this Court in its order of February 20, 1968. The temporary stay order was vacated on March 4, 1968.

Republic National filed its notice of appeal to the United States Court of Appeals for the Ninth Circuit (Record 103) and its appeal bond (Record 104).

CONTESTED ISSUES

I.

Whether the District Court erred in granting a stay under Section 3 of the United States Arbitration Act (9 U.S.C. Section 3) without passing upon the question of whether the McCarran-Ferguson Act (15 U.S.C. Section 1011, et seq.) prohibited its application to insurance companies.

II.

Whether the District Court erred in failing to pass upon the facts of whether there was a written arbitration agreement between the parties and arbitrable issues.

III.

Whether the District Court could grant a stay under its general stay powers in view of the Kerotest doctrine.

IV.

Whether it was error to mandate the questions of fact and law essential to a motion for stay under Section 3 of the Arbitration Act, to the court having jurisdiction of an action to compel arbitration under Section 4 of the Act.

SUMMARY OF ARGUMENT

Republic National contends that since the United States Arbitration Act is not one of the few federal enactments

specified by the McCarran Act to apply to the business of insurance, and, since the Arbitration Act itself has never specified by its provisions that it specifically applies to insurance companies, the Congressional intent embodied in the McCarran Act (15 U.S.C., Sections 1011-1015) must be obeyed and thus exempts this action from the provisions of the United States Arbitration Act. By contrast, the District Court has read 9 U.S.C., Sections 3 and 4 to require that a stay for arbitration be granted before it is decided if the McCarran Act bars application to these parties of the very act pursuant to which the stay was granted. Republic National submits that it is altogether illogical to obtain any result under the Arbitration Act until it is first established that the subject matter of the contract of reinsurance is within the definition of Sections 1 and 2 of the Arbitration Act.

In addition to this basic jurisdictional question, Republic National submits that even if the United States Arbitration Act applies to the business of insurance, it must first be established that a written arbitration agreement exists among the parties to this dispute and that there are disputed issues in the pending action which are subject to arbitration under the terms of such an agreement, if any. Tri-parte contractual arrangements and issues cannot be hauled into arbitration by the vehicle of a biparte arbitration agreement. These issues must be decided by the court having jurisdiction of the motion for stay and cannot properly be mandated to another district court for decision.

Therefore, because of the failure to pass upon the threshold jurisdictional question resulting from the conflict between the McCarran-Ferguson Act and the United States Arbitration Act, as well as the refusal to pass upon the factual contentions concerning the reinsurance arrangement at issue and the disputes which have arisen under it, the stay order of the district court was granted in error.

In addition, it would have been improper for the court to act under any general stay power inherent in the district courts because of the Kerotest doctrine, which holds that in a concurrent jurisdictional matter the first court to have jurisdiction of the parties and subject matter is the proper court to try the issues. No general stay would be proper and there is nothing in the United States Arbitration Act or any other statute which authorizes the procedures used here of "consolidating" the motion for stay in the Arizona court with the petition to compel arbitration in the New York court.

POINT I

The Honorable District Court erred in applying Section 3 of the Federal Arbitration Act, as such Act does not apply to insurance companies in view of the McCarran-Ferguson Act (15 U.S.C., Sections 1011, et seq.).

ARGUMENT UNDER POINT I

The first crucial point to be determined before deciding the question of a stay of action under the United States Arbitration Act is whether the Act itself applies to the con-

tract in question. A stay under Section 3 of the Act can only be granted when contracts subject to Sections 1 and 2 are involved. *Bernhardt v. Polygraphic Company of America*, 350 U.S. 198, 76 S. Ct. 273 (1956), *Ross v. Twentieth Century-Fox Film Corp.*, 236 F. 2d 632 (9th Cir. 1956), *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 87 S. Ct. 1801, ... L. Ed. ..... (1967). The Honorable District Court's refusal to rule on this threshold issue, while at the same time granting a stay under Section 3, is basic error. The application of the Arbitration Act to a contract outside the scope of Sections 1 and 2 of the Arbitration Act invades the province of local law reserved to the states by *Erie Railroad v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, and *Bernhardt*, supra.

The Federal Arbitration Act applies to a contract evidencing transactions involving commerce, containing written arbitration provisions. 9 U.S.C., Section 2. The Act derives its authority from Article 1, Section 8, Clause 3 of the United States Constitution, which gives to Congress the power to regulate commerce among the several states. It is the Appellant's position that the United States Arbitration Act does not apply to insurance companies because of the McCarran-Ferguson Act. The Arbitration Act does not apply to all matters and has not been applied when in conflict with more specific acts which are definitive of public policy. See *Wilco v. Swan*, 346 U.S. 427, 64 S. Ct. 182, 98 L. Ed. 168 (1954) and *American Safety Equipment Co. v. J. P. McGuire & Co.*, ... F. 2d ..... (2d

Cir Mar. 20, 1968). The history of the McCarran Act is important to this issue.

In 1944 the Supreme Court, in *United States v. South-Eastern Underwriters Association*, 322 U.S. 533, 64 S. Ct. 1162, held that the business of insurance was interstate commerce. It has been held that reinsurance is the business of insurance. *Connecticut General Life Insurance Co. v. Johnson*, 303 U.S. 77, 58 S. Ct. 436 (1938). Following the turmoil created by the South-Eastern decision, Congress passed in 1945 the McCarran-Ferguson Act, widely known as Public Law 15 and contained at 15 U.S.C., Sections 1011-1015. This statute, with certain exceptions, left to the states the regulation of the business of insurance. The declaration of Congressional policy is contained in the first section of the Act, 15 U.S.C., Section 1011, as follows:

> "Congress declares that the continued regulation and taxation by the several states of the business of insurance is in the public interest, and that silence on the part of Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several states."

Section 1012 provides:

> "(b) No act of Congress shall be construed to invalidate, impair or supersede any law enacted by any state for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business unless such act specifically relates to the business of insurance: * * *"

The proviso stated that after a moratorium which would be in existence until June 30, 1948, the Clayton Act, the Federal Trade Commission Act and the Sherman-Antitrust Act

would not apply to the business of insurance to the extent the business was regulated by the state law. Section 1014 provided exceptions to the broad mandate returning insurance business to state control by specifically making the insurance business subject to certain Federal acts. These included the National Labor Relations Act, the Fair Labor Standards Act and the Merchant Marine Act.

All decisions construing the scope of the McCarran Act to date have drawn heavily upon the historical context of its enactment. In 1869, the Supreme Court held that issuing a policy of insurance was not a transaction in commerce. *Paul v. Virginia*, 8 Wall. 168-185, 19 L. Ed. 357 (1869). Subsequent cases consistently held that the business of insurance was not commerce. *New York Life Insurance Co. v. Deer Lodge County*, 231 U.S. 495, 503-504, 510, 34 S. Ct. 167, 172, 58 L. Ed. 332 (1913). It was unexpected, therefore, when in 1944 the United States Supreme Court, in *United States v. Southwestern Underwriters Association*, supra, held that the business of insurance was interstate commerce, and subject to regulation by Congress under the commerce clause.

In swift reaction to the *South-Eastern Underwriters* case, Congress enacted the McCarran-Ferguson Act in 1945. 15 U.S.C., Sections 1011-1014. An excellent historical narrative is incorporated in the opinion in *National Casualty Co. v. FTC*, 245 F. 2d 883, 887 (6th Cir. 1957) aff'd., 357 U.S. 560, 78 S. Ct. 1260 2 L. Ed. 2d 1540 (1958).

The overriding concern embodied in the McCarran Act was to recreate a broad field for state regulation of the insurance industry free from federal intervention, subject

only to certain exceptions specifically embodied in the Act. *National Casualty Co. v. FTC*, supra. In *SEC v. National Securities, Inc.*, 387 F. 2d 25, 29 (9th Cir. 1967) it is stated that the original reaction to *South-Eastern Underwriters* was a desire to exempt insurance from federal antitrust regulation, but that the final enactment stated a far broader policy of exclusion:

> "The focus shifted from a narrow exemption from the Sherman and Clayton Acts to a general policy of exemption with specific exceptions to that policy."

Federal enactments in the interstate commerce field prior to the McCarran Act made no mention of the exemption for insurance companies because the exemption from interstate commerce recognized in *Paul v. Virginia* was so generally accepted that Congress legislated only in terms applicable to commerce generally, without particularized reference to insurance. *Prudential Insurance Co. v. Benjamin*, 328 U.S. 408, 415, 66 S. Ct. 1142, 90 L. Ed. 1342 (1946); *SEC v. National Securities, Inc.*, supra.

It was during this period when the insurance business was considered outside the field of interstate commerce regulation that the Federal Arbitration Act, 9 U.S.C., Sections 1-14, was enacted in 1925. Consequently, prior to *South-Eastern Underwriters* in 1944, the Federal Arbitration Act had no application to the insurance business. During the interim between that decision and the enactment of the McCarran Act, it could be inferred that the Arbitration Act, together with all other federal acts relating to interstate commerce, would be potentially applicable to the business of insurance.

After the *South-Eastern Underwriters* decision, the Federal Arbitration Act was not applied to insurance companies in any reported cases, presumably because the doctrine of *Erie R.R. v. Tompkins*, 304 U.S. 64, 58 S. Ct. 817, 82 L. Ed. 1188 (1938) was generally thought to make the substantive outcome of an arbitration case depend upon applicable state laws. This distinction was the controlling consideration in *Bernhardt v. Polygraphic Company of America*, supra. It was not until June 1967, with the decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, supra, that the concept of federal substantive law embodied in the Arbitration Act distinguished this body of law from the *Erie* doctrine. This evolution explains why in the forty-three years which have intervened from the enactment of the Federal Arbitration Act this is the first known case to consider the resulting conflict between the McCarran Act and the Federal Arbitration Act.

Because of McCarran's historical context and the void of insurance cases under the Arbitration Act, it becomes important to recognize what the courts have held to be the scope of the general McCarran Act exemption. Even though the McCarran Act's genesis was directed toward exempting the insurance business from the Sherman and Clayton Acts, in its final enactment the Act generally excepted the insurance business from all coverage by past, present, and future federal statutes which do not otherwise specifically include the insurance business within their coverage. *SEC v. National Securities, Inc.*, supra. So important is this dis-

tinction that the circuit court included in its opinion the following excerpt from the Congressional Record by Senator Ferguson, the co-author of the bill:

> " 'If there is on the books of the United States a legislative act which relates to interstate commerce, if the act does not specifically relate to insurance, it would not apply at the present time. Having passed the bill now before the Senate, if Congress should tomorrow pass a law relating to interstate commerce, and should not specifically apply the law to the business of insurance, it would not be an implied repeal of this bill, and this bill would not be affected, because the Congress had not, under subdivision (b), said that the new law specifically applied to insurance.' 91 Cong. Rec. 481 (1945)."

On the same point, the circuit court also included these statements by Senators Ferguson and O'Mahoney:

> " 'MR. FERGUSON. What we have in mind is that the insurance business, being interstate commerce, if we merely enact a law relating to interstate commerce, or if there is a law now on the statute books relating in some way to interstate commerce, it would not apply to insurance. We wanted to be sure that the Congress, in its wisdom, would act specifically with reference to insurance in enacting the law.
>
> 'MR. O'MAHONEY. In other words, no existing law and no future law should, by mere implication, be applied to the business of insurance.
>
> 'MR. FERGUSON. That is correct.' 91 Cong. Rec. 1487 (1945)."

Under the scheme of the McCarran Act, this general exemption effected a moratorium on the enforcement of federal statutes in the insurance business, and thereby restored the status quo as it existed prior to *South-Eastern Underwriters. National Casualty Co. v. FTC*, supra. How-

ever, under the provisions of Section 2(b) (15 U.S.C., Section 1012(b)) the moratorium expired on a specified date as to the Sherman Act, Clayton Act and the Federal Trade Commission Act, so that these acts would then become applicable to the insurance industry "to the extent that such business is not regulated by state law." Therefore, in cases involving these three specific federal acts made conditionally effective with regard to insurance under Section 2(b), the courts are continually concerned with first establishing that the state governments have affirmatively acted to regulate within these areas before acknowledging the McCarran Act exemption. Typical of these cases are *FTC v. Travelers Health Association*, 362 U.S. 293, 80 S. Ct. 717, 4 L. Ed. 2d 724 (1960), involving Federal Trade Commission Act; and *United States v. Chicago Title & Trust Co.*, 242 F. Supp. 56 (N.D. Ill. 1965) involving Clayton Act interpretation.

We are here concerned with the broad powers left to the states to regulate the business of insurance. As pointed out in *Prudential Insurance Co. v. Benjamin*, supra, the purpose of the Act was:

> "Obviously Congress' purpose was broadly to give support to the existing and future state systems for regulating and taxing the business of insurance. This was done in two ways. One was by removing obstructions which might be thought to flow from its own power, whether dormant or exercised, except as otherwise expressly provided in the Act itself or in future legislation. The other was by declaring expressly and affirmatively that continued state regulation and taxation of this business is within the public interest and that the business and all who engage in it 'shall be subject to' the laws of the several states in these respects."

The mandate of the McCarran Act, in common everyday language, allows the states to regulate the business of insurance without any interference or priority by the Federal law except as to specifically designated areas, such as the Labor Relations Act and the Fair Labor Standards Act. But what is meant by the regulation of the insurance business? A state regulates the business of insurance within the meaning of Section 1012(a) and (b), 15 U.S.C., when a state statute generally prescribes or permits or authorizes certain conduct on the part of the insurance companies. If a state has generally authorized or permitted or prohibited certain standards of conduct, it is regulating the business of insurance under the McCarran Act. *California League of Independent Insurance Producers v. Aetna Casualty & Surety Co.*, 175 F. Supp. 857 (N.D. Cal. 1959) citing for authority *FTC v. National Casualty Co.*, 357 U.S. 560, 79 S. Ct. 1260 (1958). "Regulate" means to govern or direct according to rule, or to bring under control of constituted authority, to limit and prohibit, to arrange in proper order, and to control that which already exists. *Farmington River Co. v. Town Plan & Zoning Comm.*, 197 A. 2d 653, 660 (Super. Ct. Conn. 1963). Regulation may be by legislation, as well as by rule. *FTC v. National Casualty*, supra. Regulation prescribes the rule by which something is to be governed. *U. S. v. Darby*, 312 U.S. 100, 113, 61 S. Ct. 451, 456; *Gibbons v. Ogden*, 9 Wheat. 1, 196, 6 L. Ed. 23.

It is not necessary that the regulation contemplated by the McCarran Act be specifically, directly and solely pointed at insurance companies. No state need specifically designate

insurance companies as being within the coverage of its "regulation" in order to constitute regulation within the meaning of Section 2(a) and (b) of the McCarran Act. See *Travelers Health Association v. Virginia,* 339 U.S. 643, 70 S. Ct. 927 (1950), where Virginia's Blue Sky Law enforced by the corporation commission was upheld in its application to insurance companies. In *Professional & Businessmen's Life Insurance Co. v. Bankers Life Insurance Co.,* 163 F. Supp. 274 (D. Mont. 1958), the court concluded that an act generally applicable to all persons and corporations is sufficiently broad to constitute regulation under the McCarran Act concept.

THE STATE ARBITRATION POLICY

Texas, New York and the majority of other states have dealt with the regulation of insurance in connection with arbitration matters as shown by the passage of various arbitration acts. The Texas arbitration policy is founded on provisions of the Texas Constitution which provides, in Section 13, Article XVI:

> "It shall be the duty of the Legislature to pass such laws as may be necessary and proper to decide differences by arbitration, when the parties shall elect that method of trial."

Then, pursuant to the Constitution, the Legislature set forth the then controlling policy of Texas in the original Title 10, Article 224:

> "All persons desiring to submit any dispute, controversy or right of action supposed to have accrued to either party, to arbitration, shall have a right to do so in accordance with the provisions of this title."

The public policy of the State of Texas, as expressed in the statute, did not permit the enforcement of contracts to arbitrate future disputes — only existing disputes. 6 Tex. Jur. 2d "Arbitration" Sec. 20, *San Benito C. C. Drain. Dist. v. Farmers State Guar. Bk.*, 192 S.W. 1145 (Civ. App. 1917) writ ref'd., *Tejas Development Co. v. McGough Bros.*, 165 F. 2d 276, 280 (5th Cir. 1947), *Huntington Corp. v. Inwood Construction Co.*, 348 S.W. 2d 442 (Civ. App. 1961) writ ref'd., NRE.

In 1965, this public policy was changed to allow arbitration agreements as to future disputes, specifically excepting, however, insurance matters.

This is consistent with the position stated by Senator McCarran with regard to the scope of the Federal Act:

> "It is not required that the assertion of state regulatory authority over a particular phase or practice of the insurance business shall provide the most effective regulation possible or that it shall be equally strict as the applicable Federal law in the same field. Congress has recognized the right of the states to apply their own policy in the regulation of the business of insurance."

Whether the McCarran Act excludes insurance disputes from the Arbitration Act does not rest on the degree of positive regulation exercised by any state. According to *SEC v. National Securities, Inc.*, supra, the fact that the Federal Government has not seen fit specifically to include life insurance under the terms of the Federal Arbitration Act excludes its application to insurance companies. In

Prudential Insurance Co. v. Benjamin, supra, the court recognized that uniformity among the states in regulation is not the test.

It can hardly be said that the Federal Arbitration Act would not invalidate, impair or supersede the law of the State of Texas in regard to the precise question of enforceability of arbitration agreements as to future disputes.

While Appellant has placed in the record evidence to show that the contract here involved was a Texas contract, Hamilton has done nothing to produce for the record any evidence contradicting that of the Appellant. Hamilton has made references to its position that the contract is a New York contract, but such references have been contained only in its briefs, and such does not amount to evidence.

It is of small benefit to Hamilton, even ignoring the evidentiary problem, to attempt to impose the status of a New York contract in this case. The New York Arbitration Law holds that when the validity of a contract containing an arbitration clause is at issue it is a matter for determination by the courts and not the arbitrators. Among the exceptions to the enforceability of arbitration contracts under the New York Statute are cases where it is contended the contract is voidable or never came into existence, and contentions of the illegality of the contract, these being questions going to the contract itself, and thus being matters for the court to decide. *Exercycle Corp. v. Maratta*, 9 N.Y. 2d 329, 174 N.E. 2d 463 (N.Y. Ct. App. 1961).

The Honorable District Court chose to grant a stay under Section 3 of the Federal Arbitration Act, although reserving serious doubts as to its application to this case in view of the McCarran Act. The applicability of the McCarran Act to the case at bar posed a basic jurisdictional question to be decided before Section 3 of the Arbitration Act could be determined to be applicable. This jurisdictional question was not decided as required by the Statute and by the Supreme Court cases of *Bernhardt*, supra, and *Prima Paint*, supra.

POINT II

The Honorable Trial Court erred in granting a stay under Section 3 of the Arbitration Act because there was no evidence of any issues involved in the proceeding which were referable to arbitration under an arbitration agreement between the parties.

ARGUMENT UNDER POINT II

Section 3 of the Federal Arbitration Act provides as follows:

> "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, *upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement*, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. July 30, 1947, c. 392, Sec. 1, 61 Stat. 669." (emphasis ours)

Neither of the Defendants in the Trial Court have filed responsive pleadings on the merits to Plaintiff's Complaint. Hamilton filed motions relating to its request for stay under 9 U.S.C., Section 3, claiming that disputes were involved which were properly referable to arbitration under a written arbitration agreement. The proceeding for a stay under the Federal Arbitration Act is considered an application for injunction. *Shanferoke Coal & Supply Corp. v. Westchester Service Corp.*, 293 U.S. 449, 55 S. Ct. 313 (1935). As such the party moving for the stay has the burden of persuasion in showing facts which will authorize a stay under 9 U.S.C., Section 3. It was the first duty of the Honorable District Court, under Section 3 (assuming said Arbitration Act is applicable) to determine whether there was a written agreement to arbitrate and whether any of the issues raised in the suit were within the reach of the agreement.

The leading case to this effect arose in the Second Circuit in *Engineers Association v. Sperry Gyroscope Co.*, 251 F. 2d 133 (2d Cir. 1957). There, the Court of Appeals recognized that the determination of the arbitrability of the grievance depended upon the same facts relevant to a decision by an arbitrator upon the merits of the grievance. The Court held that the fact that the same issues would be involved in both proceedings did not relieve the Trial Court from determining the facts as a prerequisite to adjudging the dispute arbitrable. In emphasizing this point the Court stated:

> "This duty cannot be adequately performed unless the court examines the facts upon which the demand for arbitration is based as those facts relate to the language

> of the agreement. See Industrial Trades Union v. Woonsocket Dyeing Co., D.C. R.I. 1954, 122 F. Supp. 872. To make out a case for arbitration, Sperry's alleged breach must be 'put into issue by facts, as distinguished from unsupported charges. * * *' Application of Berger, supra, 78 N.Y.S. 2d at page 532; General Olympic Co. v. United Electrical Radio & Machine Workers, 1949, 300 N.Y. 252, 90 N.E. 2d 181."

It is also the prevailing rule in the Ninth Circuit that the submission to arbitration rests in the first instance on a determination of all relevant fact issues regarding whether the dispute is one subject to arbitration. In *Ets-Hokin & Galvan, Inc. v. United States ex rel. Albert S. Pratt, Inc.*, 350 F. 2d 871 (9th Cir. 1965), upon appeal of the order denying a stay, the Court vacated the order and remanded to the District Court, holding that relevant facts supplied by a record of a state court action must be examined before a competent determination of the arbitration question could be made.

While the pleadings amply demonstrate the terms of two written undertakings between Hamilton and Republic on the one hand, and between Republic National and Financial Security on the other, the substance of Point I in the Complaint is that the entire contract to be construed consisted of parol agreements between all three of the companies, pursuant to which the portions of the agreement relating to certain aspects of the actual cession of life cases were committed to the biparty contracts. This is demonstrated by the affidavit of Mr. William A. Boles.

Mr. Boles states that there were no negotiations for any arbitration agreement between the three parties. Most assuredly, no writing has been produced to date which will conform to the requirement of 9 U.S.C., Section 3.

Also, from the Boles affidavit, it is clear that the entire contractual arrangement was dependent upon a single exchange of consideration, which supports the allegations of the Complaint that the relationship between the three parties for which declaratory judgment is sought was a single integration, which was then reduced to writing as concerns the cession agreements between Republic National and Hamilton, and between Republic National and Financial Security. The record is completely devoid of any evidence submitted by Hamilton denying the existence of arrangements between the three parties to this lawsuit. Instead, Hamilton seeks only to splinter the existing lawsuit into two or more lawsuits by pleading the Federal Arbitration Statute, and by this procedural maneuver seeks to divorce itself from its prior connection and participation in the handling of the reinsurance and coinsurance of this business with its sister company, Financial Security.

As stated in the Statute (9 U.S.C., Section 3) the Court must be "satisfied that the issue involved in such suit * * * if referable to arbitration." As the record stands it is completely devoid of any evidence at all which would show the existence of arbitrable issues involved in the present case. Aside from a legal memorandum claiming that some other district court should decide these issues, Hamilton has not sought to introduce evidence or identify what

arbitrable issues and claims make this case referable to arbitration as provided in Section 3 of the Arbitration Act. Since nothing more was produced, Plaintiff's affidavits on the subject would be controlling and Hamilton's burden of proof has not been met.

If a factual dispute can be demonstrated by Hamilton through materials authorized under Rule 56, then the issues will have been joined and subjected to determination by the proper rules of evidence under the authority of *Engineers Association v. Sperry Gyroscope*, supra. The Federal Arbitration Act can only be invoked upon the foundation of proven fact demonstrating that the Act itself is in fact applicable. This involves not only the jurisdictional questions presented by Republic National but also the factual questions of the existence of a written arbitration agreement between the parties and the further finding of the existence of arbitrable disputes or issues. Since Hamilton wholly failed to carry its burden in establishing such issues and agreement, there was nothing upon which the Trial Court could make findings of fact in support of its order staying a litigation.

POINT III

Although the District Court's inherent power to stay its own actions is not involved in this case, it would not be properly applicable.

ARGUMENT UNDER POINT III

Hamilton did not base its motion for stay upon any general power of the Court, although such was referred to in part of its briefing. The motion upon which the orders

were granted was a motion to stay, under 9 U.S.C., Section 3. The Court itself did not invoke any general stay power, basing its order solely and specifically upon Section 3 of the Federal Arbitration Act.

No stay under general powers of courts would have been proper in this case. Plaintiff filed its Complaint in the District Court on November 3, 1967. On November 11, 1967 Hamilton filed a petition to compel arbitration in the Southern District of New York, followed by a motion dated December 15, 1967 in the District Court for the District of Arizona moving for, among other things, a stay of action pending arbitration. The District Court of Arizona had jurisdiction of the subject matter and all the parties prior to the action of Hamilton to compel arbitration in the Southern District of New York or to stay the Arizona proceedings pending arbitration.

The situation presented to the Court by the sequence of events summarized above has been the subject of frequent judicial discussions in the last few years. A typical situation of the kind presented here is one where party A commences an action against party B in one jurisdiction, followed by a suit involving the same issues and parties, together with a third party in another district court. The question which naturally develops is in which of the two courts the proceedings shall be heard to conclusion. If the question is not resolved there could conceivably result two hearings involving the same issues being prosecuted in two different jurisdictions.

The leading case on this point is *Kerotest Manufacturing Co. v. C-O Two Fire Equipment Co.*, 189 F. 2d 31 (3d Cir. 1950). There, the Circuit Court held that the court which first acquired jurisdiction of all the parties necessary to decide all issues and controversies existing between the parties should be the correct forum to retain jurisdiction. In commenting on this, the court said:

> "In the instant case the whole of the war and all the parties to it are in the Chicago theatre and there only can it be fought to a finish as the litigations are now cast. On the other hand if the battle is waged in the Delaware arena there is a strong probability that the Chicago suit nonetheless would have to be proceeded with for Acme is not and cannot be made a party to the Delaware litigation. The Chicago suit when adjudicated will bind all the parties in both cases. Why, under the circumstances, should there be two litigations where one will suffice? We can find no adequate reason. We assume, of course, that there will be prompt action in the Chicago theatre."

This case was subsequently affirmed by the U.S. Supreme court, which cited the quoted language of the Third Circuit opinion with approval, and held that the proper remedy was to enjoin the parties from proceeding with the litigation of the parallel case in any other jurisdiction. *Kerotest Manufacturing Co. v. C-O Two Fire Equipment Co.*, 302 U.S. 180, 2 S. Ct. 219 (1952).

Following the *Kerotest* doctrine there has developed an impressive succession of cases from the various circuit courts which are applicable in this situation. In *Martin v. Graybar Electric Co., Inc.*, 255 F. 2d 202 (7th Cir. 1959), the court held that a district court may consider this jurisdictional

question as a matter of discretion, but that discretion must be applied objectively, and if the district court abuses that discretion it may constitute reversible error. In that case, the court applied the following rule relevant to the present action:

> "Two simultaneously pending lawsuits involving identical issues and between the same parties, the parties being transposed and each prosecuting the other independently, is certainly anything but conducive to the orderly administration of justice. We believe it to be important that there be a single determination of a controversy between the same litigants and, therefore, a party who first brings an issue into a court of competent jurisdiction should be free from the vexation of concurrent litigation over the same subject matter, and an injunction should issue enjoining the prosecution of the second suit to prevent the economic waste involved in duplicating litigation which would have an adverse effect on the prompt and efficient administration of justice unless unusual circumstances warrant. As none such appears in this record, we agree with what would seem to be the established general rule that the party filing later in time should be enjoined from further prosecution of his suit. (Case citations omitted)"

As a further outgrowth of the *Kerotest* doctrine, the Court of Appeals for the Second Circuit in 1961 held that the first court to obtain jurisdiction over the parties and of all the issues in controversy should proceed with an adjudication of the case on its merits, and that the parties attempting to litigate elsewhere are properly enjoined, stating the rule as follows:

> "The bulk of authority supports the position that when a case is brought in one federal district court, and the case so brought embraces essentially the same trans-

> actions as those in a case pending in another federal district court, the latter court may enjoin the suitor in the more recently commenced case from taking any further action in the prosecution of that case. (Citations omitted)" *National Equipment Rental, Ltd. v. Fowler*, 287 F. 2d 43 (2d Cir. 1961).

Of particular importance to this case is the decision in *Small v. Wageman* 291 F. 2d 734 (1st Cir. 1961). Here, the same subject matter was before two different district courts, but less than all of the parties to the first action were involved in the subsequent suit. The court observed that the sound judicial policy of avoiding a multiplicity of actions dictates that the court which has jurisdiction of sufficient parties to hear the entire controversy should proceed, and enjoin the parties from litigating the same subject matter in another district. That court pointed out that to do otherwise would conceivably result in two actions in different jurisdictions, neither of which could be completely dispositive of all the questions which could be determined if all of the parties were to be heard in the single jurisdiction which had jurisdiction over all of them.

In the present case, the court for the Arizona District has jurisdiction to determine all questions relating to rights between the three insurance companies under their coinsurance and reinsurance arrangement, and the respective constituent written contracts. It is only in the Arizona District Court that jurisdiction of all the parties lies and it is only there that the full consideration and final determination of the rights, duties, and obligations of all the parties to the coinsurance arrangement can be determined. The District Court fully acknowledged the Kerotest doctrine and

rule in granting the preliminary injunction against Hamilton proceeding in the New York action.

It is for these reasons that no general stay proceedings would have been properly entered by the Arizona Court and the Court correctly did not base its orders upon the application of such power.

POINT IV

The Honorable District Court erred in holding that the issues under Section 3 and Section 4 should be considered together in the action pending under Section 4 of the Arbitration Act.

ARGUMENT UNDER POINT IV

The Court in its order indicated that defenses to the charge of refusal to arbitrate should be heard and determined in connection with the petition to compel arbitration, which was pending in the United States District Court for the Southern District of New York. The only issue in question in New York is the question raised under 9 U.S.C., Section 4, which provides for the petition for an order to compel arbitration. The Statute provides as follows:

> "A party aggrived by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any court of the United States which, save for such agreement, would have jurisdiction under the judicial code at law, in equity, or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. * * * The court shall hear the parties, and upon being satisfied that

> the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. * * *"

Section 3 of the Arbitration Act provides:

> "If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. July 30, 1947, c. 392, Sec. 1, 61 Stat. 669."

These statutes are not mutual, as envisioned by the Appellee. Apart from the obvious inconsistency of mandating questions to be decided from one district court to another, the Supreme Court has delineated the issues which can be raised under 9 U.S.C., Section 4, and it would be impossible for the New York District Court to consider the issues properly raised under Section 3 as part of the petition under Section 4 without exceeding the limits that the Supreme Court has recognized. In *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 87 S. Ct. 1801, 1806, the court stated:

> "Under Section 4, with respect to a matter within the jurisdiction of the Federal Courts save for the existence of an arbitration clause, the court is instructed to order arbitration to proceed once it is satisfied that 'the making of the agreement for arbitration or the failure to

comply (with the arbitration agreement) is not in issue:' "

The existence of arbitrable issues is solely for determination under Section 3, which in turn is dependent upon finding that the act itself is the proper rule of law to be applied to the subject matter at issue.

An action under Section 3 of the Arbitration Act, if successful, merely arrests further action by the court itself in the lawsuit until something outside the suit has occurred. The court does not order that that outside action shall be done. Under Section 4 the court, through the exercise of discretionary equity powers, affirmatively orders that someone do some act outside the suit. The absence of the power to compel performance of an arbitration agreement by the court in which a motion to stay under Section 3 is filed, is not destructive of that court's jurisdiction. See *Shanferoke Coal & Supply Corp. v. Westchester Service Corp.*, 293 U.S. 449, 55 S. Ct. 313, 79 L. Ed. 583 (1935) and *Kulukundis Shipping Company v. Amtorg Trading Corp.*, 126 F. 2d 978, 988 (2d Cir. 1942). It is, of course, possible that some of the same issues may be involved in the action under Section 4 as would be involved under Section 3, but this is no different than the existence of some identity of issues in two proceedings, one a court and one an arbitration tribunal. In such a case, *Engineers Association v. Sperry Gyroscope Co.*, 251 F. 2d 133 (2d Cir. 1957) the court held that such an identity of issues in the two proceedings would not relieve the court of its duty to determine whether arbitrable disputes existed. What the court has here attempt-

ed is the transfer of the limited questions of jurisdiction and fact to another district court for decision by use of a 9 U.S.C., Section 3 stay. Hamilton filed a motion to sever and transfer all actions against it to New York and such motion was overruled, and properly so. *Hoffman v. Blaski*, 363 U.S. 335, 80 S. Ct. 1084 (1960). There is no authority for the partial "transfer or consolidation" here attempted.

CONCLUSION

WHEREFORE, for the reasons above discussed, the action of the Honorable District Court in staying its action and referring questions of law and fact to another district court without first passing upon the jurisdictional questions involved, the application of the McCarran-Ferguson Act to the subject matter of this suit, and the failure to find facts necessary under Sections 1, 2 and 3 of the United States Arbitration Act was in error and the orders of the District Court should be reversed.

Respectfully submitted,

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I certify that, in connection with the preparation of this brief I have examined Rules 18, 19, and 39 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing Brief is in full compliance with those rules.

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Attorney

A copy of the foregoing Brief has been served by mail this 1st day of May, 1968, upon Mr. John P. Frank of the firm of Lewis, Roca, Beauchamp & Linton, 114 West Adams Street, Phoenix, Arizona 85003, Attorneys for Appellees.

Robert A. Holland

UNITED STATES CODE ANNOTATED

TITLE 9
ARBITRATION

Section 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce. July 30, 1947, c. 392, Section 1, 61 Stat. 669.

Section 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle

by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to abitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract. July 30, 1947, c. 392, Section 1, 61 Stat. 669.

Section 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration. July 30, 1947, c. 392, Section 1, 61 Stat. 669.

Section 4. Failure to arbitrate under agreement; petition to United States Court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for

arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues

to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof. As amended Sept. 3, 1954, c. 1263, Section 19, 68 Stat. 1233.

UNITED STATES CODE ANNOTATED

TITLE 15

COMMERCE AND TRADE
SECTIONS 1011-1014
THE McCARRAN-FERGUSON ACT

Section 1011. Declaration of policy

Congress declares that the continued regulation and taxation by the several States of the business of insurance is in the public interest, and that silence on the part of the Congress shall not be construed to impose any barrier to the regulation or taxation of such business by the several States. Mar. 9, 1945, c. 20, Sec. 1, 59 Stat. 33.

Section 1012. Regulation by State law, Federal law relating specifically to insurance; applicability of certain Federal laws after June 30, 1948

(a) The business of insurance, and every person engaged therein, shall be subject to the laws of the several States which relate to the regulation or taxation of such business.

(b) No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance, or which imposes a fee or tax upon such business, unless such Act specifically relates to the

business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended, shall be applicable to the business of insurance to the extent that such business is not regulated by State law. Mar. 9, 1945, c. 20, Secs. 2, 59 Stat. 34; July 25, 1947, c. 326, 61 Stat. 448.

Section 1013. Suspension until June 30, 1948, of application of certain Federal laws; Sherman Anti-Trust Act applicable to agreements to, or acts of, boycott, coercion, or intimidation

(a) Until June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, and the Act of June 19, 1936, known as the Robinson-Patman Anti-Discrimination Act, shall not apply to the business of insurance or to acts in the conduct thereof.

(b) Nothing contained in this chapter shall render the said Sherman Act inapplicable to any agreement to boycott, coerce, or intimidate, or act of boycott, coercion, or intimidation. Mar. 9, 1945, c. 20, Secs. 3, 59 Stat. 34; July 25, 1947, c. 326, 61 Stat. 448.

Section 1014. Applicability of National Labor Relations Act and the Fair Labor Standards Act of 1938

Nothing contained in this chapter shall be construed to affect in any manner the application to the business of

insurance of the Act of July 5, 1935, as amended, known as the National Labor Relations Act, or the Act of June 25, 1938, as amended, known as the Fair Labor Standards Act of 1938, or the Act of June 5, 1920, known as the Merchant Marine Act, 1920. Mar. 9, 1945, c. 20, Secs. 4, 59 Stat. 34.